A reminder of the key EU baseline provisions

The key changes introduced by the EU Audit legislation are:

- **Mandatory Audit Firm Rotation (MFR):** A requirement for auditors of a PIE to rotate every ten years with a Member State option to extend audit firm tenure for either a tender or joint audit arrangement.

- **Non-Audit Services Prohibitions (NAS):** A list of prohibitions that apply to services provided by the statutory auditor and its network, in respect of services provided to the audited entity, its parent undertaking or controlled entities, based in the EU. The NAS provisions do not apply to sister entities of the EU PIE unless they themselves are EU PIEs.

- **NAS Fee Caps:** The introduction of a 70% cap on NAS fees as a percentage of the average of the audit fees for the previous three years.

- **Auditor reporting:** Introduces additional reporting requirements for the statutory auditor of EU PIEs covering the statutory audit report, audit committee reporting and reporting to supervisory bodies of PIEs.

Sweden—recent developments

- The EU audit reform has been implemented in Sweden through changes to the legislation approved by the Parliament on 18 May 2016.

- The new rules have been aligned with the ‘EU baseline’ with the exemption of the two tier approach Sweden has adopted to MFR rules, meaning:
  - Banks and insurance companies are only granted a ten year rotation period without the option to extend;
  - All other PIEs can apply the option to extend* by means of a tender or joint audit.

- Sweden has availed of the option to permit tax and valuation services according to Article 5 of the Regulation.

- The effective date has been aligned with the ‘EU baseline’ effective date – 17 June 2016. The regulation with respect to the prohibited Non-Audit Services as per Art 5 (1) of the Regulation has been deemed by the Swedish Institute (FAR) to apply for reporting periods beginning on or after 17 June 2016.

*As permitted under Article 17, paragraph 4 of the Regulation
### EU Baseline

The EU PIE definition is unchanged from the 2006 Statutory Audit Directive (the 8th Directive) however, the practical impact of being a PIE is broader than previously. The EU new directive defines a PIE as any entity incorporated in an EU Member State with:

1. debt or shares admitted to trading on an EU regulated market; or
2. credit institutions (e.g. non-listed and licensed under regulation to take deposits in the EU); or
3. insurance undertakings (e.g. non-listed regulated insurance activities, irrespective of whether they are life, non-life or reinsurance undertakings); or
4. entities designated by local Member States to be of public interest.

Statutory auditors of a PIE are required to:

- Rotate at least every 10 years (subject to a Member State option);
- With a Member State option to extend audit firm tenure to:
  - a maximum of 20 years (subject to a public tender process being held after 10 years); or
  - a maximum of 24 years (subject to a joint audit arrangement).

When the start of the first financial year of the audit engagement is:

- On or before 16 June 1994, a PIE cannot renew or enter into an audit engagement with the auditor for the financial year beginning on or after 17 June 2020.
- Between 17 June 1994 and 16 June 2003, a PIE cannot renew or enter into an audit engagement for the financial year beginning on or after 17 June 2023.
- Between 17 June 2003 and 16 June 2006: PIES need to conduct a tender and reappoint the existing auditors or appoint new auditors so that the new audit engagement takes effect for the next financial year beginning after 16 June 2016. Member States will determine whether an audit straddling 17 June 2016 could be completed.
- For audits commencing 17 June 2006 onwards, when an audit engagement reaches a maximum duration of 10 years since first appointed, the auditor can not be reappointed other than on the basis of a tender or joint audit.

Requires KAPs to rotate after a maximum of seven years, followed by a three-year cooling-off period. Member States have the option to elect shorter KAP rotation periods.

### Sweden

The PIE definition is Swedish law is equivalent to the one in the ‘EU baseline’.

Sweden has taken a two tier approach to MFR, where the local rules have been defined as follows:

- The standard MFR period for all PIEs will be 10 years.
- Banks and insurance undertakings cannot extend audit firm tenures beyond the initial 10 years.
- All other PIEs are granted the option to extend for a further 10 years via a tender or a further 14 years for a joint audit.
- Initial audit engagement period is minimum one year and maximum four years.

The MFR transition periods are aligned with the ‘EU baseline’.

When the start of the first financial year of the audit engagement is:

- On or before 16 June 1994, a PIE cannot renew or enter into an audit engagement with the auditor for the financial year beginning on or after 17 June 2020.
- Between 17 June 1994 and 16 June 2003, a PIE cannot renew or enter into an audit engagement for the financial year beginning on or after 17 June 2023.
- Between 17 June 2003 and 16 June 2006: PIES need to conduct a tender and reappoint the existing auditors or appoint new auditors so that the new audit engagement takes effect for the next financial year beginning after 16 June 2016. Member States will determine whether an audit straddling 17 June 2016 could be completed.
- For audits commencing 17 June 2006 onwards, when an audit engagement reaches a maximum duration of 10 years since first appointed, the auditor can not be reappointed other than on the basis of a tender or joint audit.

Sweden retains a seven year rotation cycle for KAPs.

### What does this mean in practice?

Credit institutions and insurance undertakings are new categories of PIEs in Sweden under the new legislation.

This comes from the fact that Sweden has chosen to utilise the option to make an exception when the 8th Directive was implemented in Sweden.

The shorter rotation period for banks and insurance companies are likely to result into more frequent changes of audit firms in the financial sector. It may also have effects on industry groups which have banks and insurance companies as subsidiaries. Please also refer to the comment above.

It should be noted that Sweden has a long tradition of appointing individual physical persons, as well as audit firms, as auditors of an entity. This creates a number of rather complicated questions in relation to how the EU Regulation should be interpreted when related to individuals being appointed as auditors of an entity.

In response to added complexity with respect to the rotation of auditors in Sweden, the Swedish Institute (FAR), has issued a guidance, EtikU14 together with a Q&A, which interprets several of the key questions with regard to this area.
### EU Baseline

The list of NAS which statutory auditors and members of their network are prohibited from providing to their PIE statutory audit clients is included in Appendix 1. Member States have the option to add to this list.

The audit firm may NOT provide such NAS during the time between the beginning of the period audited and the issuing of the audit report. There is also a ‘clean period’ required from the financial year preceding the start of the year to be audited for; 'Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems'.

Valuation and certain tax services (with the exception of customs taxes and payroll tax) are subject to Member State derogation (Appendix 1) meaning they could be permitted. In the event of such a derogation the audit committee must conclude and document that the services in question have no direct or have an immaterial effect on the financial statements and do not compromise the auditor’s independence.

Fees earned by the auditor of the PIE for permissible NAS are capped at 70% - though Member States have the option to establish stricter rules on the NAS fee cap, including a lower %.

Any NAS that is not explicitly prohibited to the audited PIE, its parent undertaking or its controlled undertakings is permissible.

Approval by the Audit Committee is needed following an assessment of the threats to independence and the safeguards.

Member States may introduce a list of permitted services.

The EU requirements largely align with the new ISA requirements, although there are still some additional unique EU disclosures such as an independence declaration and an indication of the length of the audit/client relationship. In addition:

**For PIEs**, the audit report will need to provide:
- a description of the most significant assessed risks of material misstatement, including assessed risks of material misstatement due to fraud;
- a summary of the auditor’s response to those risks; and
- where relevant, key observations arising with respect to those risks.

**For ALL statutory audits in the EU** the audit report will need to:
- ‘provide a statement on any material uncertainty relating to events or conditions that may cast significant doubt about the entity’s ability to continue as a going concern’.

### Sweden

Sweden follows the ‘EU baseline’ and the Member State derogation to permit tax and valuation services has been fully adopted.

Swedish legislation follows the ‘EU baseline’.

The Swedish Institute (FAR) has proposed three new recommendations with respect to the application of the new requirements. The recommendations are expected to be issued after the consultation period has closed in mid August 2016.

Increased transparency – the audit report will include a description of the risks identified by the auditor and the procedures performed.

### What does this mean in practice?

The real challenge continues to be interpreting the nature of the services that are to be prohibited. The auditor needs to ensure the personal independence requirements are complied with. In particular, the ‘clean period requirement’ will be a challenge.

Swedish legislation follows the ‘EU baseline’.

The new functions of the Audit Committee include the pre-approval of NAS, confirmation of the auditor’s independence and handling the tender or bid to select the audit firm.

The Swedish Institute (FAR) has interpreted the timing of the application of the pre-approval requirement as follows: The new NAS rules should come into force for financial years beginning on or after 17 June 2016.

For further guidance on the role of the Audit Committee see the KPMG Audit Committee Institute handbook.
Appendix 1

Prohibited Non-Audit Services as per Art 5 (1) of the Regulation

1. A statutory auditor or an audit firm carrying out the statutory audit of a public-interest entity, or any member of the network to which the statutory auditor or the audit firm belongs, shall not directly or indirectly provide to the audited entity, to its parent undertaking or to its controlled undertakings within the Union any prohibited non-audit services in:
   a. the period between the beginning of the period audited and the issuing of the audit report; and
   b. the financial year immediately preceding the period referred to in point (a) in relation to the services listed in point (e) of the second subparagraph.

For the purposes of this Article, prohibited non-audit services shall mean:
   a. Tax Services relating to:
      i. preparation of tax forms*;
      ii. payroll tax;
      iii. customs duties;
      iv. identification of public subsidies and tax incentives unless support from the statutory auditor or the audit firm in respect of such services is required by law*;
      v. support regarding tax inspections by tax authorities unless support from the statutory auditor or the audit firm in respect of such inspection is required by law*;
      vi. calculation of direct and indirect tax and deferred tax*;
      vii. provision of tax advice*;
   b. Services that involve playing any part in the management or decision-making of the audited entity;
   c. Bookkeeping and preparing accounting records and financial statements;
   d. Payroll services;
   e. Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems;
   f. Valuation services, including valuations performed in connection with actuarial services or litigation support services*;
   g. Legal services, with respect to:
      i. the provision of general counsel;
      ii. negotiating on behalf of the audited entity; and
      iii. acting in an advocacy role in the resolution of litigation
   h. Services related to the audited entity’s internal audit function;
   i. Services linked to the financing, capital structure and allocation, and investment strategy of the audited entity, except providing assurance services in relation to the financial statements, such as the issuing of comfort letters in connection with prospectuses issued by the audited entity;
   j. Promoting, dealing in, or underwriting shares in the audited entity;
   k. Human resources services, with respect to:
      i. management in a position to exert significant influence over the preparation of the accounting records or financial statements which are the subject of the statutory audit, where such services involve:
         – searching for or seeking out candidates for such position; or
         – undertaking reference checks of candidates for such positions
      ii. structuring the organisation design; and
      iii. cost control.

* Services subject to the Member State derogation